

California Film & Tax Credit Program 2.0

AGREED UPON PROCEDURES

~~February 1, 2015~~ Nov 17, 2015

I. Introduction

The California Film & Television Job Retention and Promotion Act provides tax credits for qualified expenditures incurred when producing qualified motion pictures. The tax credits can be used to offset either California personal or corporate income taxes or sales and use taxes. A production company requesting a tax credit must submit an Independent Certified Public Accountant's Report on Applying Agreed-Upon Procedures (the 'Report') to demonstrate compliance with the program's requirements.

II. Statutory References

California Revenue and Taxation Code Sections:

1. 6902.5 (sales and use tax)
2. 17053.95 (personal income tax)
3. 23695 (corporate income tax)
4. California Code of Regulations, Title 10, Chapter 7.75, Sections 5508 - 5516

III. General

The following Agreed Upon Procedures (AUP) are to be performed by a certified public accountant (CPA) with an active California license to perform attest services. The CPA cannot provide production accounting services and agreed upon procedures services to the same production company as per Rule 101 of the American Institute of Certified Public Accountants Code of Professional Conduct and its interpretations and rulings. The CPA shall have successfully completed a California Film & Tax Credit Program 2.0 Orientation Meeting for CPAs. The Accounting firm performing attest services must provide a letter from the board of review in the state in which the firm resides, evidencing the firm has actively participated in a peer review program for CPA firms performing Agreed Upon Procedures within the past 3 years from date services are rendered and has received a "pass" on said review. If the firm performing attest services is newly formed, the firm must provide evidence it is registered with the board of review in the state in which the firm resides for a peer review in the future.

The selected CPA must have sufficient knowledge of accounting principles and practices generally recognized in the film and television production industry. The CPA shall read the statute, regulations, guidelines, Qualified Expenditure Charts, Budget Tagging and Tracking Tips, and all other materials posted on the California Film Commission website.

1. The Report shall be prepared for the use of the following specified parties:
 - a. The production company; and
 - b. The California Film Commission

2. The Report should include the California CPA license number or proof of a valid out-of-state accounting firm registration ~~the practice privilege permit number~~ for the ~~person and/or~~ firm practicing assurance-attest services.
3. The name of the production and its Credit Allocation Number must also appear on the Report.
4. The Report must be dated as of the last day of the performance of all procedures.
5. The production company's cost report must be presented in U.S. dollars.
6. The production company must provide documentation of all funds expended on the production both within and outside of California including pre-production, production and post-production periods.
7. Please include CPA name and contact information for the CPA responsible for the review and final sign off of this Report.

~~IV.~~ Agreed-Upon Procedures

The CPA shall perform the following procedures. Any exceptions are to be listed as a finding in the CPA's report on applying agreed-upon procedures.

IV. Eligibility:

1. Obtain the detailed cost ledger (e.g. Bible) of California Qualified Expenditures and Total Production Expenditures.
- ~~2.~~ Obtain access to Applicant's on-line Application and submitted materials from production company, from the California Film Commission and read the production company's tax credit application with supporting documentation, including the following: Application Form (CFC Form AA) and Qualified Expenditure Budget and Exhibit B. Indicate in Report the Job Ratio as stated by the CFC on the Application Form.
3. Obtain and read the production company's Credit Allocation Letter. Indicate in Report the CFC Approved Jobs Ratio as stated by the CFC on the Credit Allocation Letter. Note in the Report the amount of tax credits reserved and the CFC Approved Jobs Ratio number.
- ~~3.4.~~ Obtain and inspect post-production documents (e.g. facility invoices) evidencing the date the final elements (e.g., final composite answer print, air master, or digital cinema files) were created (foreign language or archival element creation does not apply). Determine and document in the Report the Qualification Period of the production. Verify that the Qualified Production Period does not exceed 30 months after the date in which the California Film Commission issued the Credit Allocation Letter.
- ~~2.5.~~ Obtain and inspect documentation (e.g. call sheets and/or production reports, shooting schedules) for all principal photography days for the production in order to determine the following:
 - a. Based upon the inspection of the documentation, state the percentage of total California principal photography days as a percentage of the total principal photography days. (The total principal photography days in California ratio can be obtained by dividing the number of days of principal photography in California by the total number of principal photography days).

- b. ~~The number of principal photography days in a Production Facility, (defined in Section 5508(u) of the Regulations); state the percentage of principal photography facility days in California.~~
- b.e. ~~State The the~~ number of principal photography days outside the Los Angeles zone (OZ days), as per Revenue and Taxation Code Section 17053.95(a)(4)(D)(i)(II)(ib) and Section 23695(a)(4)(D)(i)(II)(ib); only include in the day count OZ PP days in which the first scene of the day was photographed outside the LA zone. Note amount of OZ days in Report and state the percentage of principal photography days outside the Los Angeles zone.
- ~~3.6.~~ If the production does not meet the 75% principal photography day test in Section 5(a) above, perform the following procedures:
- Obtain a detailed cost ledger of Total California Expenditures (including qualified and non-qualified expenditures) and the Total Production ~~Budget Expenditures~~. State the ratio of Total California Expenditures to the Total Production ~~Budget Expenditures~~.
 - Select a sample of expenditures from the Total California Expenditure population (including qualified and non-qualified expenditures) according to the sampling methodology noted in Appendix A.
 - For each expenditure item selected, obtain and inspect invoices, proof of payment (e.g., bank statements, check images, credit card statement and reimbursement checks, if applicable) or other equivalent documentation. Verify that the expenditure amount agrees to the invoice, was incurred and paid for services and goods in California. The full value of all assets may be taken when determining eligibility if assets were rented or purchased and used in California. Adjust for known errors and recalculate Total California Expenditures and determine if 75% of Total Production ~~Budget Expenditures~~ was-were spent in California.
- ~~4.7.~~ Inspect the detailed cost ledger of Total Production Expenditures to determine that the Total Production Expenditures meet the ~~maximum and~~ minimum thresholds for Feature Films, Independent Films, Movies of the Week, Miniseries, Pilots and Television Series per the statute.
8. Obtain verification form letter from the production company issued by the designated representative of a career based learning and training program approved by the CFC which states that the production company has satisfied all the requirements. This form letter is a requirement to be eligible for the issuance of the tax credit certificate. ~~Please include~~Include a copy of the form letter with the Report. If production company made a financial contribution, obtain proof of payment and include in Report.
9. If the production has not met eligibility standards as noted above, there is no need to continue with the agreed upon procedures. Notify production company management to inform the CFC that they are ineligible for the tax credit program.

V. Expenditures (other than payroll) - Inside and Outside the Los Angeles Zone:

Select the sample from the detailed cost ledger ~~for inside the Los Angeles Zone costs~~ according to the sampling methodology noted in Appendix A. For Television Series, the CPA must sample items ~~for from~~ each episode, including amortization costs. For purposes of selecting Stratum 1 and Stratum 2, the sample should be selected in proportion to the costs inside the LA zone (QE), and outside the Los Angeles Zone non-consumables (ZE) and outside the LA zone consumables (ZC) (if applicable), as calculated in Eligibility procedure 5 (c) (e.g., *If expenditures are between \$1M and \$5M and it is a population between \$500.00-\$25,000.00 and 80% of the expenditures were inside the L.A. Zone, select 80% of 50 items - 40 items*). The Top Stratum should be selected for both inside and outside of the Los Angeles Zone (all QE, all ZE, all ZC).

1. For each expenditure item selected in the sample perform the following procedures:

- a. Inspect invoices, proof of payment (e.g., bank statements, check images, credit card statement and reimbursement checks, if applicable) or other equivalent documentation. Verify that expenditure amount is correct, incurred and paid for services incurred and goods purchased or rented and used in California. Expenditures must be purchased or rented from a California In-State Vendor as per Section 5508(d) in the Regulations. If purchased from an internet source, verify purchase was shipped from a California location to a California location.
- b. Verify that the expenditure was not associated with activities specifically excluded by the statute.
- c. Verify that the expenditure was allowable as defined by sections 17053.95(b)(16) and (b)(18)(B)(i)-(iv) and sections 23695(b)(16) and (b)(18)(B)(i)-(iv) of the statute. In particular, inspect travel costs, living allowances and per diems.
- d. Verify that the expenditure was not for in-kind services.
- e. Verify that the expenditure was recorded net of any refunds, insurance claims, credit notes received for discounts, rebates, invoicing errors, and purchase returns, as recorded in the cost report.
- f. Verify that the expenditure was recorded net of proceeds from any sale of the production assets.
- g. Verify that the expenditures purchased and rented in California are ~~is~~ pro-rated to reflect any usage out of the state.
- h. If applicable, and expenditure is determined to be a digital asset with a purchase price over \$250.00 or an asset with a purchase price of \$10,000 or more, verify the asset is included in the correct asset listing. If it is not included, include asset in listing.
- i. Verify that the expenditure (regardless of when paid) was not incurred prior to the date in which the Credit Allocation Letter (CAL) was issued. For the qualified items listed which required full or partial payment, such as insurance premiums, completion bond, or office rent, made prior to the issuance of the CAL, confirm that these costs are pro-rated by the number of pre-production, production and post-production weeks and that only the pro-rated costs after the CAL date are included in California Qualified Expenditures.
- j. Verify that expenditure (regardless of when paid) was not incurred more than 30 days after creation of the final elements.
- k. For out of zone expenditures:
 - (1) Inspect call sheets, production reports, invoices, location agreements, etc. to determine the item was purchased or rented outside the Los Angeles zone during the Applicable Period, as defined in Section 5508(o).
 - (2) Verify that the items were purchased or rented from an outside the Los Angeles zone vendor as defined in Section 5508(n) in the Regulations.
 - (3) Reclassify any items which were not purchased or rented out of the Los Angeles zone to expenditures inside the Los Angeles zone.

~~2.If applicable, verify that insurance costs are prorated for preproduction, production or post production outside of CA.~~

2.3 Obtain from the production company a statement, either separately or within a representative letter, that all outstanding purchase orders and all invoices for qualified expenditures have been paid. If applicable, for any invoices or purchases orders that have not been paid, attach listing detailing vendor and amount owed to the Report deduct expenditures from Qualified Expenditure total.

3.4 Inspect the detailed cost ledger and determine that all Qualified Expenditures were not incurred prior to the issuance of the Credit Allocation Letter and no more than 30 days after the creation of the final elements regardless of when paid. Inquire with company regarding any amounts paid after creation of the final element to verify that the service, rental or purchase was incurred prior to 30 days after final element creation. Adjust CA Qualified Expenditures for any amounts incurred past the 30 day element creation date.

4. For the qualified items listed which required full or partial payment, such as insurance premiums, completion bond, or office rent, made prior to the issuance of the CAL, confirm that these costs are prorated by the number of preproduction, production and postproduction weeks and that only the pro-rated costs after the CAL date are included in California Qualified Expenditures. For pro-rated insurance premiums and/or completion bonds, confirm that these costs are pro-rated by the number of pre-production ,production and post production weeks and that only the pro-rated costs after the CAL date are included in the the CA Qualified Expenditures. obtain a statement of allocation from the California based broker and/or completion bond company and attach to Report.

5. Obtain fixed asset listings from the production company of all assets used in the production as follows: (1) all electronic, digital and effects equipment with a purchase price greater than \$250; and (2) all other assets not considered electronic, digital and effects equipment with an original purchase price over \$10,000. The listings should indicate the status of the assets (e.g. destroyed, sold, donated, being held for future productions, given to cast or crew, etc.). Attach a copy of both listings to the Report. For all assets on the listings perform the following procedures

- a. For all electronic/digital assets (Include digital assets purchased for set dressing and/or prop purposes) including but not limited to computers, hardware and relevant components, printers, copiers, etc. with a purchase price greater than \$250, verify that the California Qualified Expenditure is the lesser of the net costs of the asset after sales proceeds (if assets sold) or 20% of the original cost.
- b. For all assets over \$10,000 not including electronic/digital equipment, verify the following: (1) If the asset is sold, verify that the California Qualified Expenditure is the lesser of the net costs of the asset after sales proceeds or 50% of the original cost of such asset; (2) If the asset is retained, verify that the California Qualified Expenditure is 50% of the original cost of such asset; (3) If the asset is destroyed during the process of production, verify that the production company maintains documentation to support the destruction of the asset (e.g. call sheets, production reports, still photographs, video footage, etc.) and allow 100% of that asset; and (4) If the asset is given to a non-qualifying cast or crew member or sold to a non-qualifying cast or crew member for less than 50% of original purchase price, verify that the cost of such asset is not included in the California Qualified Expenditures.
- c. Inspect Qualified Expenditures for any purchased digital assets over \$250.00 not included on digital asset list and include in digital asset listing.
- d. ~~e.~~ For exceptions noted in procedures (a), ~~and (b), and (c)~~ above, adjust the Qualified California Production Expenditures for known errors noted and attach a listing of those errors.

6. Obtain a listing of customized leased or rented items which are manufactured, assembled, or fabricated to specification with lease payments aggregating \$10,000 or more. Verify that these items

are included on the asset listing noted above (Expenditures, procedure 5) if they meet any one of the following four conditions:

- a. If the term of the lease exceeds 75% of the life of the asset;*
- b. If there is a transfer of ownership to the lessee at the end of the lease term;
- c. If there is an option to purchase the asset for substantially less than fair market value ("Bargain price") at the end of the lease term;*
- d. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset.

Any such rental or lease agreement that meets the above standards for a capital lease will be considered a purchase and subject to the 50% limitation for purposes of determining California Qualified Expenditures as per above expenditure procedure 5 (b).

*If the asset value or asset life is not explicit, please contact the CFC to discuss.

~~7. If completion bond costs are included in qualified spend, obtain total completion bond costs and recalculate as a percentage of qualified expenditures not to exceed 2%. If cost exceeds 2%, reduce completion bond fee to no more than 2% of qualified spend.~~

~~8.7.~~ Verify with Production Company the names of any and all visual effects, digital effects, post production sound and/or title companies who worked on the production whose costs are being claimed as qualified expenditures. Verify that all listed parties have provided the production company with documentation (e.g., signed letter on letterhead signed by CEO, CFO or equivalent managerial level personnel with knowledge of the project, with contact information including address and phone number) indicating the percentage-dollar amount of work which was performed in the state, ~~and the dollar amount~~. If applicable, the letter must state the names of any subcontractors and indicate the percentage and dollar amount of work that was performed in the state through those sub-contracted vendors. Verify that only the amount of work performed within the state of California is included in the California Qualified Expenditures total. Adjust California Qualified Expenditures for any work which was not performed in California. Include vendor letters and list of such vendors with Report.

~~8.9.~~ Verify with Production Company that any insurance claims related to qualified expenditures have been properly credited in the cost report and obtain a signed letter from a production company representative (or as part of a rep letter) stating that the applicant (indicated in the Credit Allocation Letter) has properly disclosed all insurance claims whose costs are being claimed as qualified expenditures. Verify that completion bond expenditures, if applicable, are reported net after rebate.

~~9. 40.~~ For exceptions noted in the expenditure test in procedure 1 above (not including payroll), for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing.

~~10.44.~~ For exceptions noted in the expenditures test in procedure 1 above (not including payroll), for the sample identified in the Stratum 1 and Stratum 2 in Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 and Stratum 2 sample was selected (refer to **Appendix B** for a misstatement example). Perform the following procedures based upon the results of the calculation of the projected misstatement:

- a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures (non-payroll), document the projected misstatement in the Report. Do not make any adjustment to the California Production Expenditures for a projected misstatement.

- b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures, select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1 and Stratum 2. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make an adjustment to the California Qualified Expenditures for a projected misstatement; however, do adjust the California Qualified Expenditures for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.
- c. Attach a listing of any exceptions noted in the expenditure test in procedure 1 and 11(b) above (expenditures other than payroll). The listing should include amount, vendor/person, and nature of discrepancy.

VI. Payroll –(Wage) Expenditures - Inside and Outside the Los Angeles Zone

1. Obtain documentation (e.g., email or letter on letterhead signed by authorized representative) from the payroll service verifying that there are no outstanding invoices pending for work incurred up to 30 days after the creation of the final element. Adjust California Qualified Expenditures for any non-paid invoices. Include letter or email with documentation submitted with Report.
2. Select a sample of employees from the Qualified Wages in the detailed cost ledger ~~for inside the Los Angeles Zone costs~~ according to the sampling methodology noted in Appendix A. For a Television Series, the CPA must sample from each episode, including amortization costs. For purposes of selecting Stratum 1, the sample should be selected in proportion to the costs inside and outside the Los Angeles Zone, if applicable, as calculated in Eligibility procedure 5(~~eb~~). The Top Stratum should be selected for both inside and outside of the Los Angeles Zone (QW), (ZW). For each employee selected in the sample perform the following procedures:
 - a. Compare the amount of the Qualified Wages in the detailed cost ledger for the individual with the summary payroll report from payroll company issued no earlier than 30 days after creation of the final element.
 - b. Inspect time cards, production reports, call sheets or other equivalent documentation. Verify that wage amount is incurred for services performed in California.
 - c. Inspect invoices from “qualified entities”. Verify the date the expenditure was incurred, and that the loan out company name and the amount of the expenditure agrees with supporting payroll records. Verify that the expenditure was incurred in California.
 - d. Verify that the “qualified wages” only include those expenses listed in Revenue and Taxation Code Section 17053.95(b)(21)(A)(i)-(iv) or Section 23695(b)(21)(A)(i)-(iv) and do not include any of the expenses listed in Section 17053.95(b)(21)(B)(i)-(iv) or Section 23695 (b)(21)(B) (i)-(iv).
 - e. Determine that only “qualified individuals” as defined in Revenue and Taxation Code Section 17053.95(b)(17) or 23695(b)(17), received “qualified wages”.
 - f. Verify that all Qualified Wages do not include compensation for any work incurred out of the state.

- g. Verify that the payroll expenditure (regardless of when paid) was not incurred prior to the date in which the Credit Allocation Letter (CAL) was issued.
- h. Verify that payroll expenditure (regardless of when paid) was not incurred more than 30 days after creation of the final elements.
- i. Verify that the Qualified Wages are paid by Production company or its payroll service and only include qualified wages, qualified fringes, meal penalties, overtime, mileage and car, living, wardrobe and meal allowances (tagged as QW or ZW). Exclude box rentals and cell phone allowances (should be tagged QE).
- j. For wages indicated as outside the Los Angeles zone labor (ZW), inspect call sheets, production reports, payroll records, time sheets, location agreements, etc. to determine that the Qualified Wage was incurred outside the Los Angeles zone during the Applicable Period as defined in Section 5508(a) of the Regulations. Time cards may designate “bus to” for a nearby location outside the Los Angeles Zone and should include city and state.

(1) Recalculate the Qualified Wages incurred Out of the LA zone and compare them to the amount qualified in the detailed ledger. Reclassify any amounts improperly tagged as OZ.

3. ~~Inspect the detailed cost ledger and~~ If exceptions were noted in procedures above, ~~sort determine that all~~ Qualified Wages by dates incurred to determine that they were not incurred prior to the issuance of the Credit Allocation Letter and no more than 30 days after the creation of the final elements regardless of when paid.

4. Inspect the detailed cost ledger and verify that it only contains account codes entered for qualified individuals as defined in Revenue and Taxation Code Section 17053.95(b)(17)(A) or 23695(b)(17)(B), and that all wages are qualified as defined in 17053.95(b)(21)(A)(i)-(iv) or 23695(b)(21)(A)(i)-(iv). Adjust California Qualified Expenditures for any non-qualified individuals or misclassified wages.

5. Obtain the final “galley” or checker” or electronic version of the main (if applicable) and end title credits for the production.

- a. For those below the line (BTL) individuals (e.g., Unit Production Managers, Production Supervisors, First Assistant Directors, Post Production Supervisors, Visual Effects Supervisors) who also are receiving an on screen producer (e.g. executive, line, co-, associate, visual effects, music, post) credit, verify that qualified wages only include: up to \$100,000 in Director Guild of America (DGA) wages; industry standard wages; or wages equivalent with other crew in similar positions.

b. a. For those individuals receiving both above the line and below the line credits, please note in the Report the names and qualified compensation for each individual for each end title credit received. Adjust California Qualified Expenditures for any below the line crew also receiving an ATL producer credit whose BTL wages are not within industry standards, or equivalent with other crew in similar positions, or above Verify that Qualified wages for DGA Unit Production Managers and/or Assistant Directors with ATL credits have no more than \$100,000 in wages (exclusive of ~~ding~~ guild or union or other qualified taxes, fees, or fringes, if applicable). If determination cannot be reached, contact the CFC to discuss.

~~e.b.~~ Review the main and end title credits for all individuals working in non-qualified positions e.g., performers, producers, directors, composer, etc. Perform search in qualified wage expenditures to insure their individual wages are not included in qualified spend. Verify that all non-qualified individuals receiving only an ATL credit have no qualified wages included in the CA Qualified Production Expenditures. Adjust the Qualified California Production Expenditures for known errors.

~~c. d.~~ —Include a listing of all personnel with both above the line and below the line salaries and findings as an attachment to the Report.

6. Verify with Production Company that any insurance claims related to qualified wages have been properly credited in the cost report and obtain a signed letter from a production company representative stating that the applicant (indicated in the Credit Allocation Letter) has properly disclosed all insurance claims whose costs are being claimed as qualified wages. The information in this letter can be incorporated into a rep letter requested in Expenditures (other than payroll).
7. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing.
8. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in Stratum 1 in Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:
 - a. If the projected misstatement (payroll) does not exceed 2% of Qualified California Production Expenditures, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for the projected misstatement.
 - b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures (payroll), select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for a projected misstatement; however, do adjust the California Qualified Expenditures for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.
 - c. Attach a listing of any exceptions noted in the payroll test in procedures 2 and 8 (b) above. The listing should include amount, person or entity, and nature of discrepancy.

VII. Related Parties & Other Affiliations:

1. Obtain from the production company a schedule listing of all related party transactions (including parties with a 5% or greater ownership in or affiliation with the production company) for which the production company is including the transactions in the California Qualified Expenditures. The

listing should note the type of relationship between the related party and the production company and the nature and amount of the transactions.

2. Obtain a signed letter from a production company representative stating that the applicant (indicated in the Credit Allocation Letter) has properly disclosed all related parties and related party transactions and that the schedules produced in accordance with item number 1 above are complete and accurate. This statement may be included in a Rep letter. Attach letter to documentation submitted with Report.
3. From the schedule obtained in item number 1, select a sample of related party transactions for testing. Select all transactions greater than \$25,000; if related party issues were addressed, it is not necessary to retest items tested in procedure (1) Expenditures (Other than payroll) and/or procedure (2) Payroll. For the transactions less than \$25,000, haphazardly select 15 transactions for testing. Perform the following procedures for each related party transaction selection:

a. For non-payroll expenditures:

~~(1) i~~ (1) i Inspect studio rate cards or comparison bids obtained by production company to determine that related party transactions did not exceed the highest rate/bid. In addition, inspect pass-through vendor invoices to determine no markup was added. Any expenditures above the highest rate/bid and/or which were marked up when passed through the related party must be noted and explained on the related party transaction listing attachment, see procedure ~~#4~~.

~~(2) ii~~ (2) ii Verify that the expenditure is allowable as per Expenditures (other than payroll) section (1) ~~i~~ (a-gi).

b. For wages paid to related parties:

~~(1) i~~ (1) i Verify that any amounts paid to individuals as defined in Revenue and Taxation Code Sections 17053.95 (b)(17)(B)(i-ii) and 23695(b)(17)(B)(i-ii) are not included in the California Qualified Expenditures.

~~(2) ii~~ (2) ii Verify that the wage is allowable as per Payroll section ~~(4) i~~ (b-h).

~~(3) iii~~ (3) iii Compare rate of pay with applicable union rate or industry standard for position. If industry standard wages for type of position in relation to production type and budget levels are not explicit, contact CFC.

~~(4) iv~~ (4) iv Attach a listing (electronic) of all related party transactions obtained in procedure #1. Note and explain any sampled transactions that did not have comparison bids, were above the higher rate/bid, and/or were marked up when passed through the related party.

VIII. Non-Independent Productions: Additional 5% tax credit calculation “Uplifts” (This procedure is not applicable to Relocating Series in their first season in California). Input findings verified in this section into Exhibit A-1 to calculate uplifts.

- ~~1.~~ 1. ~~Identify the total amount of Visual Effects (VFX) expenditures from vendor letters in Expenditures (other than payroll) (8) and inspection of invoices, ledgers, etc. Calculate the amount spent on visual effects in California over the total VFX cost incurred; note the percentage and amount incurred in CA in the Report. If the production spent a total of \$10 million dollars or 75% of total actual VFX spend, production is qualified for the 5% VFX uplift. Utilized Exhibit A1 for VFX costs that qualify for the additional 5% tax credit as per section 5508(v) of the Regulations~~

1. Visual Effects: Inspect ledger, invoices, etc. for total production expenditures and determine if production spent either a minimum of \$10 million dollars or 75% of their total worldwide VFX expenditures on qualified VFX in California. If so, note percentages and amount in Report.

a. If applicable, verify that expenditures tagged VU qualify for the additional 5% tax credit ("VU Uplift") as per section 5508(aa) of the Regulations by reviewing VFX categories indicated in green on the applicable Qualified Expenditure Chart (QEC).

b. Cross reference amounts from vendor letters in Expenditures other than Payroll (7) and inspection of invoices, ledgers, etc.

2. Music Track Recording and/or Music Scoring: Obtain a listing of all costs related to music track recording and/or scoring, e.g., payroll records from applicable payroll service and invoices, proof of payment etc. from production company which qualify for the additional 5% tax credit as per the QEC and section 5512(d)(1) of the Regulations.

- a. Payroll: Aggregate the top 10 payroll transactions and verify through documentation that the work was performed in CA and related to music track recording and/or scoring. Select at random 15 payroll transactions and verify through documentation, e.g., time sheets, personnel records, invoices etc., that the work was performed in CA and related to music track recording and/or scoring. If not explicit, consult the CFC.
- b. Non-Payroll: Select 15 non-payroll transactions at random and verify through documentation that the expenditures were purchased, rented and incurred in CA and related to music track recording and/or music scoring. If not explicit, consult the CFC.
- c. Adjust the music track recording and/or scoring costs for known errors. Attach a listing of any exceptions noted in the test.

~~d. Utilize Exhibit A1 for music costs that qualify for the additional 5% tax credit.~~

3. Out of Zone (OZ):

a. Wages

(1). Utilize findings in Payroll (wage) expenditures (2)(j)(1) to determine amount of Out of Zone qualified wages eligible for additional 5% tax credit for all eligible OZ principal photography days. Note in Report.

b. Non-wages – excluding productions with total consumables

(1) Utilize findings in Expenditures (other than payroll) Section V (9-10)) to determine all qualified non-wage expenditures.

(a). Utilize findings in Eligibility (5b) to prorate the sum from procedure above by utilizing the percentage of principal photography OZ days in relation to total CA principal photography days.

c. Non-wages - including productions with total consumables

(1). Utilize findings in Expenditures (other than payroll) Section V (9-10) to determine all qualified non-wage expenditures outside the Los Angeles zone; exclude items considered totally consumed as defined in Section 5512 (d)(4)(b) of the Regulations if specifically indicated by production company.

(a). Utilize findings in Eligibility (5b) to prorate the sum from procedure above by utilizing the percentage of principal photography OZ days in relation to total CA principal photography days.

Expenditures (other than payroll)– Out of Los Angeles Zone

1. ~~Select the sample from the detailed cost ledger for outside the Los Angeles Zone costs according to the sampling methodology noted in Appendix A. For Television Series, the CPA must sample items from each episode, including amortization costs. For purposes of selecting Stratum 1 and Stratum 2, the sample should be selected in proportion to the costs inside and outside the Los Angeles Zone, as calculated in Eligibility procedure 5 (c). The Top Stratum should be selected for both inside and outside of the Los Angeles Zone.~~
2. ~~For each expenditure item selected in the sample perform the following procedures:~~
 - a. ~~Inspect invoices, proof of payment (e.g., bank statements, check images, credit card statement and reimbursement checks, if applicable) or other equivalent documentation. Verify that expenditure amount is correct, incurred and paid for services and goods used in California.~~
 - b. ~~Verify that the expenditure was not associated with activities specifically excluded by the statute.~~
 - c. ~~Verify that the expenditure was allowable as defined by sections 17053.95(b)(16) and (b)(18)(B)(i)-(iv) and sections 23695(b)(16) and (b)(18)(B)(i)-(iv) of the statute. In particular, inspect travel costs, living allowances and per diems.~~
 - d. ~~Verify that the expenditure was not for in-kind services.~~
 - e. ~~Verify that the expenditure was recorded net of any refunds, insurance claims, credit notes received for discounts, rebates, invoicing errors, and purchase returns, as recorded in the cost report.~~
 - f. ~~Verify that the expenditure was recorded net of proceeds from any sale of the production assets.~~
 - g. ~~Verify that the expenditure is pro-rated to reflect any usage out of the state.~~
 - h. ~~Verify that the items was purchased or rented from an outside the Los Angeles Zone vendor as defined in Section 5508 (n) in the Regulations.~~
 - i. ~~Inspect call sheets, production reports, invoices, location agreements, etc. to determine the item was purchased or leased and used outside the Los Angeles zone during the Applicable Period, as defined in Section 5508 (a)~~
 - j. ~~For items that were not completely consumed outside of the Los Angeles Zone as per Section 5512(d)(4)(A) of the Regulations, confirm proration is appropriate based on the ratio of principal photography days outside the Los Angeles Zone to the total number of days of principal photography.~~
 - k. ~~For items completely consumed outside of the Los Angeles Zone,, verify item is the type of item that is completely consumed as per Section 5512(d)(4)(B) of the Regulations. If verified as used and totally consumed outside the Los Angeles zone, 100% of the purchase or rental price is allowed for purposes of computing the tax credit.~~

- ~~3. Inspect the detailed cost ledger and determine that all Qualified Expenditures outside the LA Zone were not incurred prior to the issuance of the Credit Allocation Letter and no more than 30 days after the creation of the final elements regardless of when paid.~~
- ~~4. For exceptions noted in the Expenditures (other than payroll) test in procedure 2 above, for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures Out of the Los Angeles zone for known errors noted during your testing.~~
- ~~5. For exceptions noted in the Expenditure (other than payroll) test in procedure 2 above, for the sample identified in Stratum 1 in Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. (Refer to Appendix B for a misstatement example) For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:~~
 - ~~a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures Out of the LA Zone, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures Out of the LA Zone for the projected misstatement.~~
 - ~~b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures Outside the LA Zone, select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures Outside the LA Zone for a projected misstatement; however, do adjust the California Qualified Expenditures Outside the Los Angeles zone for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures Outside the Los Angeles zone, adjust the Qualified California Expenditures Outside the Los Angeles zone for the average of the two projected misstatements.~~
 - ~~c. Attach a listing of any exceptions noted in the payroll test in procedures 2 and 5(b) above. The listing should include amount, entity, and nature of discrepancy.~~

~~Payroll Expenditures – Outside the Los Angeles zone~~

- ~~1. Select a sample of employees from the Qualified Wages in the detailed cost ledger for outside the Los Angeles Zone costs according to the sampling methodology noted in Appendix A. For a Television Series, the CPA must sample from each episode, including amortization costs. For purposes of selecting Stratum 1, the sample should be selected in proportion to the costs inside and outside the Los Angeles Zone, as calculated in Eligibility procedure 5(c). The Top Stratum should be selected for both inside and outside of the Los Angeles Zone.~~
 - ~~a. Compare the amount of the Qualified Wages in the detailed cost ledger for the individual with the summary payroll report.~~
 - ~~b. Inspect time cards, production reports, call sheets or other equivalent documentation. Verify that wage amount is incurred for services performed in California.~~

- ~~c. Inspect invoices from “qualified entities”. Verify the date the expenditure was incurred, and that the loan-out company name and the amount of the expenditure agrees with supporting payroll records. Verify that the expenditure was incurred in California.~~
 - ~~d. Verify that the “qualified wages” only include those expenses listed in Revenue and Taxation Code Section 17053.95(b)(21)(A)(i)-(iv) or Section 23695(b)(21)(A)(i)-(iv) and do not include any of the expenses listed in Section 17053.95(b)(21)(B)(i)-(iv) or Section 23695 (b)(21)(B)(i)-(iv).~~
 - ~~e. Determine that only “qualified individuals” as defined in Revenue and Taxation Code Section 17053.95(b)(17) or 23695(b)(17), received “qualified wages”.~~
 - ~~f. Verify that all Qualified Wages do not include compensation for any work incurred out of the state.~~
 - ~~g. Inspect call sheets, production reports, payroll records, time sheets, location agreements, etc. to determine that the Qualified Wage was incurred outside the Los Angeles zone during the Applicable Period. Time cards may designate “bus to” for a nearby location outside the Los Angeles Zone and should include city and state.~~
- ~~2. Inspect the detailed cost ledger and determine that all Qualified Wages outside the Los Angeles Zone (payroll) were not incurred prior to issuance of the CAL or no more than 30 days after creation of the final element.~~
 - ~~3. Inspect the detailed cost ledger and verify that there are not any account codes entered for non-qualified job positions as defined in Revenue and Taxation Code Section 17053.95(b)(21)(B)(i)-(iv) or 23695(b)(21)(B)(i)-(iv), and contain wages classified as qualified as defined in 17053.95(b)(21)(A)(i)-(iv) or 23695(b)(21)(A)(i)-(iv). Adjust California Qualified Expenditures Outside the Los Angeles zone for misclassified wages.~~
 - ~~4. For exceptions noted in the payroll test in procedure 1 above, for the sample identified in the Top Stratum of Appendix A adjust the Qualified California Production Expenditures Outside the Los Angeles Zone (payroll) for known errors noted during your testing.~~
 - ~~5. For exceptions noted in the payroll test in procedure 1 above, for the sample identified in Stratum 1 in Appendix A, adjust the Qualified California Production Expenditures Outside the Los Angeles zone (payroll) for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:~~
 - ~~a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures Outside the LA Zone (payroll), document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures Outside the Los Angeles zone (payroll) for the projected misstatement.~~
 - ~~a. If the projected misstatement exceeds 2% of Qualified California Production Expenditures outside the Los Angeles zone (Payroll), select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for a projected misstatement; however, do adjust~~

~~the California Qualified Expenditures for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures Outside the Los Angeles zone (payroll), adjust the Qualified California Expenditures Outside the Los Angeles zone (payroll) for the average of the two projected misstatements.~~

- ~~b. Attach a listing of any exceptions noted in the payroll test in procedures 1 and 6(b) above. The listing should include amount, person or entity, and nature of discrepancy.~~

IX. Re-computation of Jobs Ratio

Inspect call sheets, production reports, schedules, and script supervisor's report to determine the following:

1. Qualified Visual Effects

- a. Utilizing findings from procedure 1(a&b) in Section VIII, state the amount of qualified visual effects performed in California eligible for additional percentage points. Note in Report.

2. Out of Los Angeles Zone Days

- a. Utilizing findings from Eligibility(5b), state the number of principal photography days outside the Los Angeles zone as defined in Revenue and Taxation Code Section 17053.95(a)(4)(D)(i)(II)(ib) and Section 23695(a)(4)(D)(i)(II)(ib); state the percentage of principal photography days outside the Los Angeles zone as a percentage of the total principal photography days in California.

3. Production Facility Days

- a. If applicable, obtain facility agreement and verify inclusion on Production Facility listing or proof of approval by CFC. If not included on list or CFC approved, note in the Report and do not include days in non-approved facilities when calculating additional percentage points.
- b. Determine if the shooting crew utilized a Production Facility for 6 hours or more. If less than 6 hours, do not include day as a Production Facility day.
- c. Based on findings in (a) and (b), state the number of principal photography days in a Production Facility, (defined in Section 5508(v) of the Regulations); state the percentage of principal photography facility days in California.

4.4— Obtain Adjusted Jobs Ratio Comparison Calculator (Exhibit B) from Production Company. Utilize Exhibit B in order to compute the jobs ratio. Input actualized verified expenditures, and principal photography shooting days, and tax credit estimate excluding completion bond fees or any "uplifts". Include the completed Exhibit B as an attachment to the Report.

2. 5. Compare original CFC approved adjusted jobs ratio from Eligibility procedure 2-3 to the re-computed adjusted jobs ratio. If the new adjusted jobs ratio is significantly lower than the original jobs ratio, apply the applicable penalty may apply: according to the type of production, if applicable:

- a. Non-independent projects - If the job ratio has been reduced by more than 10 percent, the credit will be reduced by the total percentage, (e.g. if 9%, no reduction; if 12%

reduction, than the penalty percentage is 12%). If the penalty percentage is over 20%, state in Report.

- b. Independent projects - If the jobs ratio has been reduced by more than 30 percent, reduce the amount of credit allowed by an equal percentage plus 10% (e.g. if 29%, no reduction if 32%, than the penalty percentage is 42%).

6. 3 If the production company states there is reasonable cause as defined in Title 10, Section 5508(~~vw~~), to justify the reduction in the jobs ratio, please inform a representative of the production company to contact the CFC. Once the CFC has made a determination, obtain verification from the CFC and recalculate the jobs ratio if necessary.

X. Wrap Up Procedures

1. If applicable, verify and note that the independent film did not exceed the \$10 million qualified expenditure budget threshold or a non-independent film did not exceed the \$100 million qualified expenditure budget threshold when computing the eligible amount of tax credits.
2. If applicable (if production does not meet the 75% principal photography test in Eligibility procedure number 5), recalculate the 75% spend test (e.g. eligibility procedure number 6) after accounting records are revised for findings in expenditures (other than payroll) and payroll procedures. Confirm that 75% of the Total Production Budget was spent for California Expenditures.
3. If completion bond costs are included in qualified spend, obtain total completion bond costs and recalculate as a percentage of qualified expenditures not to exceed 2%. If cost exceeds 2%, reduce completion bond fee to no more than 2% of qualified spend.
34. Complete and attach Exhibit A-1 for Non-Independent productions, Exhibit A-2 for Independent Productions, or Exhibit A-3 for Relocating TV Series in their first season to Report based on findings.